

# **Auditor's report**

Thaba Chweu Local Municipality

30 June 2014

# **Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Thaba Chweu Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I was engaged to audit the financial statements of the Thaba Chweu Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statements of financial performance, changes in net assets, cash flows and comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

## Basis for disclaimer of opinion

### Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment, as prior period adjustments amounting to R130 839 332 could not be substantiated. Furthermore, I could not trace selected assets from the floor to the asset register. Assets to the value of R111 675 928 could not be physically verified. Consequently, I was unable to determine whether any further adjustments were necessary relating to the property, plant and equipment of R891 552 708 (2013: R863 419 323) disclosed in note 3 to the financial statements and the statement of financial position as well as the depreciation expense of R33 077 486 (2013: R31 706 943) disclosed in note 28 to the financial statements and the statement of financial performance.

### Investment property

5. GRAP 16 *Investment property* acknowledges that judgement is needed to determine whether an asset qualifies as investment property. This standard requires an entity to develop criteria so that it can exercise that judgement consistently in accordance with the definition of investment property. Included in the balance of investment property were items that also met the definition of property, plant and equipment. I was unable to obtain sufficient appropriate audit evidence for investment property, as management did not develop criteria for the judgement used in determining whether assets recognised as investment property actually qualified as such. Consequently, I was unable to determine whether any adjustments were necessary to the investment property and fair value adjustments of R891 552 708 (2013: (R36 987 800)) and R147 470 477, respectively, as disclosed in the statement of financial position, statement of financial performance and notes 2 and 30 to the financial statements.

### Receivables from exchange transactions

6. GRAP 104 *Financial instruments* outlines the minimum indicators to be considered in assessing financial assets measured at amortised cost. Contrary to these requirements, the municipality's bad debt provision was calculated by only providing for all debt older than 120 days for the current and prior years. In the absence of appropriate records and information, I was not able to determine the full extent of the misstatement of receivables and debt impairment, as it was impracticable to do so. Furthermore, capitalised consumer debt amounting to R58 237 653 was not assessed for recoverability at year-end. Consequently, I was unable to determine whether adjustments were necessary to the receivables from exchange transactions amounting to R68 764 588 (2013: R79 637 026) disclosed in note 10 to the financial statements and debt impairment of R28 147 172 as disclosed in note 28 to the financial statements.

## **Value-added tax (VAT)**

7. The VAT reconciliation did not agree to the financial statements. I was unable to verify the unreconciled difference by alternative means, due to weaknesses in the municipality's system. I was unable to determine the impact of this on the other account balances and classes of transaction. Consequently, I was unable to determine whether any adjustments were necessary relating to the VAT receivable of R9 580 079 (2013: R2 915 245) disclosed in note 10 to the financial statements and the statement of financial position.

## **Commitments**

8. In terms of GRAP 1 *Presentation of financial statements*, other disclosures in the financial statements should include unrecognised contractual commitments. Unrecognised contractual commitments amounting to R40 693 181 identified during the audit process could not be traced to the underlying accounting records of the municipality. Consequently, commitments amounting to R2 868 002 disclosed in note 37 to the financial statement were understated by R40 693 181 (2013: R19 825 647).

## **Contingent liabilities**

9. The municipality did not provide sufficient appropriate audit evidence to support contingent liabilities amounting to R16 873 664 included in note 38 to the financial statements. I was unable to confirm this through alternative means. Consequently, I could not determine whether adjustments were necessary relating to the contingent liabilities stated at R16 873 664 (2013: R5 056 001).

## **Irregular expenditure**

10. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure, as internal controls had not been established to recognise and investigate irregular expenditure identified in the previous year. I could not confirm whether all irregular expenditure had been recorded and investigated by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the irregular expenditure of R150 572 270 (2013: R76 673 339) disclosed in note 43 to the financial statements.

## **Fruitless and wasteful expenditure**

11. Fruitless and wasteful expenditure of R19 072 199 identified during the audit process was not disclosed in the financial statements of the municipality. Consequently, the fruitless and wasteful expenditure amounting to R11 631 999 disclosed in note 42 to the financial statements was understated by R19 072 199 (2013: R16 261 563).

## **Traffic fines**

12. The municipality did not recognise traffic fine revenue on the accrual basis in accordance with iGRAP 1 applying the probability test on initial recognition of exchange revenue. The municipality recognised traffic fine revenue on the cash basis. I was unable to determine the full extent of the understatement of revenue from traffic fines and trade receivables. Consequently, I was unable to determine whether any adjustments were necessary to the revenue from fines of R799 773 disclosed in the statement of financial performance.

## **Distribution losses**

13. Section 125(2)(d)(i) of the MFMA requires the municipality to disclose the particulars of any material losses in the notes to the financial statements. The municipality did not disclose distribution losses with regard to electricity and water sales, as the municipality had not implemented adequate control measures to reliably calculate these losses. I was unable to determine the total extent of the understatement of distribution losses, as the municipality's records did not allow it.

## **Preparation of the financial statements**

14. I was unable to obtain sufficient appropriate audit evidence that the accounting officer has fulfilled his responsibility of preparing and fairly presenting the financial statements in accordance with SA Standards of GRAP, as written representations in this respect were not provided. I was also unable to obtain written representations from the accounting officer that I had been provided with all relevant information and access as agreed in terms of the audit engagement and that all transactions had been recorded and were reflected in the financial statements. I could not determine the effect of the lack of such representations on the financial position of the municipality at 30 June 2014 and its financial performance and cash flows for the year then ended.

## **Disclaimer of opinion**

15. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

## **Additional matter**

16. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Unaudited disclosure notes**

17. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.



## Report on other legal and regulatory requirements

18. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Development priority or objective A: water and sanitation on pages ... to ...
  - Development priority or objective B: roads, storm water and related maintenance on pages ... to ...
  - Development priority or objective C: electrical on pages ... to ...
  - Development priority or objective E: housing on pages ... to ...
20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected objectives are as follows:

## Water and sanitation

### Usefulness of reported performance information

### Reasons for variances not disclosed

24. No reasons for variances between planned and actual achievements reported in the annual performance report were given for 100% of the targets not achieved, as required by the National Treasury's *Guide for the preparation of the annual report*. This was due to a lack of documented and approved internal policies and procedures to address reporting requirements.

## **Consistency of objectives, indicators and targets**

25. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved integrated development plan. This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Measurability of indicators and targets**

### **Performance targets not specific and measurable**

26. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 100% of the targets.

This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Reliability of reported performance information**

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information. The municipality's records did also not permit the application of alternative audit procedures.

## **Roads, storm water and related maintenance**

### **Usefulness of reported performance information**

### **Consistency of objectives, indicators and targets**

28. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved integrated development plan. This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Measurability of indicators and targets**

29. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 75% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 75% of the targets.
- The period or deadline for the delivery of targets must be specified. A total of 25% of the targets were not time bound.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 63% of the indicators were not well defined.
- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 63% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Reliability of reported performance information**

30. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information. The municipality's records did also not permit the application of alternative audit procedures.

## **Electrical**

## **Usefulness of reported performance information**

## **Consistency of objectives, indicators and targets**

31. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives and targets were not consistent with those in the approved integrated development plan. This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.



## **Measurability of indicators and targets**

### **Performance targets not specific and measurable, and indicators not well defined and verifiable**

32. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined.
- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Reliability of reported performance information**

33. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information. The municipality's records did also not permit the application of alternative audit procedures.

## **Housing**

### **Usefulness of reported performance information**

### **Consistency of objectives, indicators and targets**

34. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved integrated development plan. This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Measurability of indicators and targets**

35. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
- The period or deadline for the delivery of targets must be specified. A total of 40% of the targets were not time bound.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined.
- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes.

## **Reliability of reported performance information**

36. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information. The municipality's records did also not permit the application of alternative audit procedures.

## **Additional matter**

37. I draw attention to the following matter:

## **Achievement of planned targets**

38. Refer to the annual performance report on pages ... to ... for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected objectives reported in paragraphs 24 to 36 of this report.

## **Compliance with legislation**

39. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

40. The performance of the Thaba Chweu Local Economic Development Agency was not monitored and annually reviewed against the agreed performance objectives and indicators as part of the annual budget process, as required by section 93B(b) of the MSA.
41. The annual performance report for the year under review did not include the name of external service providers, a comparison of the performance with set targets, a comparison with the previous financial year, and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.
42. The annual performance agreements of the municipal manager and all senior managers were not linked to the measurable performance objectives approved with the budget and to the service delivery and budget implementation plan, as required by section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
43. A performance management system and related controls were not in place, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement, and how these should be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

## **Annual financial statements, performance report and annual report**

44. Consolidated annual financial statements were not prepared, as required by section 122(2) of the MFMA.
45. The non-submission of the annual consolidated financial statements to the auditor-general for auditing was not appropriately addressed by the mayor and municipal council, as required by section 133(1) of the MFMA.
46. An oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2012-13 annual report had been tabled, as required by section 129(1) of the MFMA.
47. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimed audit opinion.

## **Procurement and contract management**

48. Sufficient appropriate audit evidence could not be obtained that all contracts had been awarded in accordance with the legislative requirements and that the procurement process was fair, equitable, transparent and competitive, as supporting documents were not provided for auditing and procurement processes were not followed.
49. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the supply chain management (SCM) policy, in contravention of SCM regulations 16(b) and 17(b).

50. Sufficient appropriate audit evidence could not be obtained that bid specifications for the procurement of goods and services through competitive bids had been drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
51. Sufficient appropriate audit evidence could not be obtained that bid specifications had been drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM regulation 27(3).
52. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding had been advertised for the required minimum period, contrary to SCM regulation 22(1) and 22(2).
53. Sufficient appropriate audit evidence could not be obtained that bids had been evaluated by bid evaluation committees composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
54. Sufficient appropriate audit evidence could not be obtained that contracts and quotations had been awarded to bidders based on points given for criteria stipulated in the original invitation for bidding and quotations, as required by SCM regulations 21(b) and 28(1)(a) and the *Preferential procurement regulations*.
55. Bid adjudication was not always done by committees composed in accordance with SCM regulation 29(2).
56. Sufficient appropriate audit evidence could not be obtained that contracts and quotations had been awarded to suppliers based on preference points allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.
57. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
58. Sufficient appropriate audit evidence could not be obtained that contracts had only been extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
59. Awards were made to providers who are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps had been taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
60. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

## **Human resource management and compensation**

61. An acting chief financial officer was appointed for a period of more than three months without the approval of the member of the executive council for local government, in contravention of section 56(1)(c) of the MSA.
62. Senior managers did not meet any of the prescribed competency areas as required by minimum competency levels regulations 6 and 7.
63. SCM managers and finance officials at middle management did not meet any of the prescribed competency areas as required by minimum competency levels regulations 8 and 9.

64. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

## **Expenditure management**

65. Money owed by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
66. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
67. An effective system of expenditure control was not in place, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
68. An adequate management, accounting and information system was not in place to account for creditors and expenses, as required by section 65(2)(b) of the MFMA.

## **Conditional grants received**

69. The municipality did not evaluate its performance in respect of programmes or functions funded by allocations of the municipal infrastructure and local government financial management grants, as required by section 12(5) of DoRA.

## **Revenue management**

70. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Asset management and liability management**

71. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
72. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Consequence management**

73. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Internal control**

74. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.



## Leadership

- 75. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
- 76. The accounting officer did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
- 77. The accounting officer did not communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities.

## Financial and performance management

- 78. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
- 79. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
- 80. Management did not review and monitor compliance with applicable laws and regulations.

## Governance

- 81. The internal audit unit operated effectively during the period under review as per their legislated mandate. Recommendations were made to management to improve internal controls and ensure reliable reporting of financial and performance information as well as compliance with legislation. However, this did not result in improved controls due to management not implementing the recommendations, which led to the adverse assessment of the impact of this unit.

*Auditor General*

Mbombela

30 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*